III. NEITHER MARKET FORCES NOR THE COMMISSION'S EXISTING SPECIAL ACCESS RATE REGULATION CAN CONCEIVABLY ADDRESS THESE MARKET POWER ABUSES.

The only way to combat the Bells' excessive special access rates is to reform rate regulations. The problem will not solve itself, because there are not (and will not be for the foreseeable future) sufficient competitive alternatives to constrain the Bells' special access pricing. And it is equally clear that the Commission's existing regulatory regime does not provide such constraints; indeed, the current regime is exacerbating the problem by facilitating the removal of even the inadequate constraints provided by price caps

A. Market Forces Cannot Constrain Bell Prices, Because IXCs and CLECs Generally Have No Choice But To Purchase Special Access From The Bells.

As explained above, the Bells have been able both to grow the special access traffic that they carry on their networks and to maintain poor provisioning and performance even as they increase their special access service rates. This is because, in the vast majority of cases, there are no alternatives to the Bells' special access services. That is unlikely to change soon, because building alternative loop and transport facilities is, in most instances, fundamentally uneconomic. And even if that were not the case, the Bells have locked carriers into long term special access contracts, thereby ensuring that IXCs and CLECs will remain captives of the Bells for at least the next several years

1. Competitive Carriers Can Self-Supply Or Use Third Party Facilities-Based Special Access Only In Very Unusual Circumstances.

Despite billions of dollars in investments, AT&T has been able to replicate only a small fraction of the Bells' high-capacity networks. Even in those limited instances where AT&T has deployed a fiber ring, it still relies on the Bell to provide both ''tails''from customers' premises to AT&T's fiber ring and "backbone" transport used to carry traffic to hubs where it can be aggregated and then carried on AT&T's fiber ring. For the "backbone" portion of AT&T's own

local network, AT&T almost never self-provides DS-1 transport and self-provides DS-3 transport only a small proportion of the time.[46] Likewise, for the "tail" portion of the network, AT&T provides a very small fraction of its own DS-I facilities.[47] The remaining service is provided almost entirely by utilizing the facilities of the Bells.[48] And even in instances in which AT&T has established connectivity to a building, landlords frequently limit AT&T to a "fiber to the floor" arrangement – *i.e.*, AT&T can serve only a particular customer with its own facilities, and not other customers in the same building.[49]

AT&T also has severely limited opportunities to expand its use of facilities-based alternatives. As explained in the attached declaration of Ken Thomas (Tab D), AT&T's long distance unit has a team charged with finding and negotiating alternative access arrangements. This team's data demonstrate, however, that CLECs have established alternative facilities to only a tiny fraction of buildings. AT&T has contractual arrangements with virtually all of the major CLECs that offer facilities-based access services, such as MFS/WorldCom, Adelphia, and Time Warner. These CLECs, however, can provide access to only a small minority of additional buildings nationwide."

Moreover, even where AT&T has a contractual arrangement with a CLEC, AT&T often cannot use that CLEC to provide access, for at least three important reasons. First, many CLECs have overstated the extent to which they have buildings "on-net." AT&T has contractual arrangements with all of the major CLECs for the right to purchase special access services to any

[46] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶ 58.

[47] *Id.* ¶ 68

[48] *Id* ¶¶ 58, 68.

[49] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶¶ 59-68

[50] ***See*** Thomas Dec. ¶¶ 6-7.

buildings in which they have facilities. Although many of these CLECs initially represented that they had a certain number of buildings "on-net," it became clear later that, in many cases, the CLECs actually relied on the Bell's special access services to reach the building."

Second, most of the major CLECs that provide alternative access are bankrupt, which has greatly diminished the ability of AT&T to use their services. Indeed, most of the buildings available to AT&T that are served by CLECs are served by Adelphia, WorldCom, and other companies in bankruptcy.[52] A carrier cannot assume that a bankrupt supplier will remain in business and continue to provide uninterrupted service. AT&T has faced numerous situations in recent months in which the continued availability of supply from one of AT&T's third party suppliers has been thrown in doubt, and AT&T has had to expend considerable resources to ensure that a backup source of supply would be available.[53] And even if AT&T had confidence in these carriers, AT&T's customers do not. As Mr. Thomas explains, potential customers are increasingly insisting that AT&T not rely on bankrupt (or potentially bankrupt) CLECs for any part of its service.[54]

Third, capacity on CLECs' networks is also often expensive, because CLECs typically provide only a modest discount off of the price umbrella of the Bells' special access services.[55] Moreover, use of a wholesaler's network often requires inefficient routing, and physically interconnecting with wholesalers' facilities often poses costly logistical and other practical problems that the ILECs typically do not face because of their large and integrated networks.

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[51] *See id.* ¶ 8

[52] *See id.* ¶ 9; *see also* AT&T Triennial Review Reply Comments, Fea-Giovannucci Reply Dec. ¶ 55.

[53] See AT&T Triennial Review Reply Comments, Fea-Giovannucci Reply Dec. ¶¶ 55-56

[54] *See* Thomas Dec. ¶ 10.

[55] *See id* ¶ 11

In short, AT&T must rely on the incumbent in the vast majority of cases. As Mr. Thomas shows, AT&T has a theoretically available, facilities-based alternative in only about five percent of the buildings in which AT&T purchases special access. And even that figure overstates the availability of alternatives, because CLEC bankruptcies, "fiber to the floor" arrangements, and similar restrictions render many of even these buildings (or portions of these buildings) unavilable to AT&T.

AT&T's experience is confirmed by the findings of the state commissions that have undertaken investigations of special access services. As the New York PSC has found, Verizon's network serves 7354 buildings in LATA 132 (Manhattan) over fiber while CLECs serve fewer than 1000 buildings.[56] Indeed, the New York PSC recently reaffirmed that "Verizon continues to be the dominant provider of high-capacity loops used to provide service to large volume customers," and that "[e]ven in lower/midtown Manhattan, Verizon facilities (retail and wholesale) still serve over half of all special service circuits."[57] Similarly, the Massachusetts DTE recently held that strict rate regulation of Verizon's intra-LATA special access service was necessary to protect competition.[58]

2. Self-Deployment Of Alternative Facilities To Provide Special Access Is Infeasible In Most Cases.

This clear lack of facilities-based alternatives to Bell special access will not change in the foreseeable future. The record from the Triennial UNE Review Proceeding demonstrates that, because of basic economic and network engineering considerations, competitors will be able to

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[56] *Opinion and Order Modifying Special Services Guidelines for Veriron New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting,* Case Nos. 00-C-2051, at 7 (NYPSC June 15,2001).

[57] Comments of New York Department of Public Service, CC Docket 01-338 *et al.,* at 5 (filed April 5, 2002).

[58] Order, DTE 01-3I-Phase I (Mass. DTE May 8, 2002)

deploy alternative facilities in only limited circumstances. Loop and transport facilities are characterized by enormous economies of scale and **sunk** costs. Thus, in most instances, replicating incumbent transmission facilities would be economically wasteful. And even in those few instances where self-deployment can be economically justified, barriers to entry such as the inability to obtain necessary rights-of-way in a timely fashion often prevent competitive deployment of facilities.

Transmission Facilities Are Characterized By Enormous Economies Of Scale. Most of the cost of deploying loops, including "high capacity" loops, is in the supporting structures, placement, rights of way, and access to buildings, and not in the conductors (fiber strand or copper wires) themselves. Because the costs of supporting structures are relatively insensitive to the number of wires of fiber deployed, the Bells enjoy substantial economies of scale.[59]

Dedicated transport is also characterized by enormous economies of scale and scope.[60] Not only do the Bells have fiber interconnecting virtually all of their LSOs (either directly or indirectly), they also generally deployed dark fiber capacity at the time of the initial facility construction, so they can dramatically increase capacity on most routes simply by adding terminating electronics at relatively minimal incremental costs (and certainly at a trivial cost compared to new construction). Thus, even on specific, high-demand point-to-point routes, a CLEC cannot hope to achieve the per-unit cost of the Bells' transport.[61]

Transmission Facilities Are Characterized By Substantial Sunk Costs. The difficulties in self-deploying transmission facilities in competition with incumbents are exacerbated by the fact that costs to construct loop and transport facilities are sunk. An investment is sunk if, once

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[59] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶¶ 6-8.

[60] *Id.* ¶ 8.

[61] *See* Ordover/Willig Dec. ¶ 40-41.

made, it cannot be re-deployed for some other use.[62] Investments spent on trenching, structure, and rights of way for a loop clearly fall into this category It is basic economics that the need to incur significant sunk costs to deploy facilities that have substantial scale economies establishes a significant entry harrier.

When investments must be sunk, an entrant will be hesitant to undertake an investment if there is a substantial risk that it will not be able to recover the costs of the investment. As Professor Willig has explained:

> The reasoning for this is straightfonvard. If costs are sunk, the potential entrant knows that it will not be able to recover its costs if it is unable to attract sufficient revenues to recover the sunk costs. At the same time, because of economies of scale, the new entrant will incur higher per-unit costs, making it difficult for it to win sufficient customers away from the incumbent. Further, because the incumbent has already sunk its costs and has very low marginal costs, there is a significant threat that the incumbent could drop its prices in response to competitive inroads at any time down to its short run costs.[63]

There is broad agreement in the economics community that industries characterized ***both*** by declining average costs *and sunk* costs are generally natural monopolies.[64] Thus, even if an entrant could reasonably approximate the scale economies of the incumbent, the existence of sunk costs and the threat that the incumbent would respond with rock-bottom prices may deter all but targeted, limited entry – a point that the Commission has repeatedly recognized.[65]

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[62] See Third Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications **Act** of 1996*, 15 FCC Rcd. 3696, 175 (1999) ("*UNE Remand Order*").

[63] AT&T Triennial Review Comments, Willig Reply Dec. ¶ 21

[64] William J. Baumol, John C. Panzar, and Robert D. Willig, CONTESTABLE MARKETS AND INDUSTRY STRUCTURE (Harcourt Brace Jovanovich, Inc., 1982); Dennis W. Carlton and Jeffrey **M.** Perloff, MODERN INDUSTRIAL ORGANIZATION (3rd ed. Addison Wesley, 2000).

[65] *See Section 257 Report*, 12 FCC Rcd. 16802, ¶ 18 n.48 (1997) ("If entry into an industry requires large sunk costs, the firm that incurs these sunk costs first (the incumbent) can have a tremendous advantage. Potential new entrants may realize that any large scale facilities-based entry into the market will probably force prices to decrease and those prices may be in fact below the point necessary to recover the sunk cost investment. **As** a result, facilities-based entry will be

CLECs ***Face Enormous Real-*** *World* ***Entry Barriers.*** Finally, the Bells enjoy a first mover advantage over any CLEC that is often dispositive. This creates a substantial entry barrier in the classic sense, for CLECs must bear costs that the Bells did not. George J. Stigler, THE ORGANIZATION OF INDUSTRY 67 (1968) (an entry barrier is "a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry"); ***see*** *also* ***Bell*** *Atlantic-NYNEX* ***Merger Order,*** 12 FCC Rcd. 19985, ¶ 129 n.247 (1997) (same).

As first movers, the Bells received rights-of-way from local governments for underground cables and telephone poles and wires with only minimal transaction costs, because persons in the neighborhood or municipality otherwise would not receive ***any*** telecommunications services. Similarly, building owners and landlords welcomed Bells that promised to bring, for the first time, telecommunications facilities to their properties. As subsequent entrants, CLECs, on the other hand, generally cannot rely on existing facilities, rights of way, or conduit.[66] Rather, CLECs must construct the loops and transport from scratch, which inevitably takes many months of pre-construction while the CLEC negotiates and secures (if possible) the necessary rights of way and construction permits from the municipality and negotiates terms of building access from the landlord.[67] Rather than welcoming additional competition, these entities often view CLEC requests for rights-of-way as a nuisance. Customers understandably do not wish to wait the many months necessary for the competitive carrier to negotiate this thicket, and they usually choose the Bell instead. For all of these reasons, there is

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deterred "), ***see also*** ***MCI-BT*** ***Merger Order,*** 12 FCC Rcd 15351, ¶ 162 (1997) (same)

[66] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec ¶¶ 11, 31

[67] *Id.* ¶¶ 32-42

no sustainable basis to conclude that the special access crisis will solve itself or that new entry can be relied upon to constrain the Bells' special access rates [68]

B. The Existing Regime **of** Special Access Rate Regulation **Is** Exacerbating the Problem.

Nor can existing rate regulation solve these fundamental problems. To the contrary, the Bells have been able to charge supracompetitive special access rates not because of lack of enforcement of the Commission's pricing regulatory regime, but because that regime is patently inadequate to prevent the exercise of the Bells' market power

Prior to the 1990s, the Commission regulated special access rates using traditional rate-of-return regulation. In 1991, the Commission adopted a "price cap" regime, which imposed a "cap" on the aggregate prices charged by Bells for certain services, including special access services. The price cap regime originally contained numerous protections for consumers, such as the "sharing" mechanism (which required price cap reductions if the Bells' rates of return exceeded a certain threshold) and the X-Factor (which required annual reductions for anticipated gains in productivity). Indeed, it is worth noting that the threshold for 100% sharing under the Commission's previous rules was never higher than 17.25%. Over the years, however, the Commission gradually relaxed and then eliminated the sharing mechanism.

In 1999, the Commission adopted the *Pricing Flexibility Order*, which established a procedure to permit price cap LECs to remove special access services from price cap regulation altogether. Under the *Pricing Flexibility Order*, a Bell need not demonstrate that competitive conditions would warrant such radical deregulation; instead, the Bell need only satisfy certain bright-line "triggers." For special access services, a Bell can obtain complete elimination of price cap regulation in a given MSA – which is known as "Phase II" pricing flexibility – if it can

[68] *See* Ordover/Willig Dec. ¶¶ 43-45

show that a certain percentage of the wire centers in that MSA have at least one collocator that is using non-ILEC transport facilities.[69]

When it adopted the *Pricing Flexibility Order*, the Commission freely acknowledged that the price cap LECs would remain dominant carriers with market power even after receiving Phase II relief.[70] The Commission nonetheless predicted that market forces would prevent the Bells from abusing that market power.[71] That prediction has now been proven wrong. The Bells have used pricing flexibility to do precisely what the Communications **Act** is designed to prevent – they have strategically raised rates to reap monopoly profits and to impede competition

IV. THE COMMISSION CANNOT LAWFULLY STAND ON THE SIDELINES WHILE THE BELLS CONTINUE TO EXPLOIT THEIR MARKET POWER OVER SPECIAL ACCESS.

It is well settled that Sections 201 and 202 of the Communications Act provide the Commission with ample authority to address the Bells' monopoly abuses[72] and responsibility to choose the appropriate method of doing so – ranging from strict cost-based rate of return regulation to an overhaul of the current price cap regime.[73] To the extent that such measures

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[69] *See Pricing Flexibility Order* ¶¶ 141-57.

[70] ***See*** *Pricing Flexibility Order* ¶¶ 90, 151

[71] Indeed, the Commission predicted that the Bells would lower their rates. ***See*** News Release, Report No. 99-33 (August 5, 1999) ("These reforms will enable [the Bells] to compete more efficiently, and customers of interstate access services should benefit from increased choices among carriers and lower overall rates"; the order ensures against "unreasonable rate increases for customers without competitive alternatives").

[72] ***See,*** *e.g., Promotion of Competitive Networks in Local Telecommunications Markets,* ***et*** *al.*, First Report And Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 22983, ¶ 134 (2000) ("It is well established that the Commission has broad authority to regulate the practices of LECs in connection with their provision of interstate communications services. In addition to the general authority specified in Title I of the Communications Act, Title II [and in particular §§ 201 and 202] provides a specific, substantive framework for the Commission's regulation of such practices.").

[73] ***See,*** *e.g., Permian Basin Area Rate Cases,* 390 U.S. 747, 790 (1968); *FERC* v. *Pennzoil Producing Co.*, 439 U.S 508, 517 (1979).

arguably entail a "change of mind by the Commission, such a change does not remotely "render the agency's action arbitrary."[74]

In fact, the Communications Act *compels* prompt elimination of these ongoing Bell market power abuses. The Act requires that "*[a]ll* charges . . . and regulations for and in connection with . . . communications service . . shall be just and reasonable."[75] Any charge or regulation that is "unjust or unreasonable is . . . unlawful."[76] And because the Commission has a "duty to execute and enforce the provisions of the Communications Act," the Commission must ensure that Bell rates for access services are "just, fair, reasonable and nondiscriminatory."[77]

As demonstrated above, the Bells' special access rates are patently unjust and unreasonable. The Bells' rates of return have been consistently rising for the last several years to increasingly unlawful levels, and since being granted pricing flexibility, the Bells have exacerbated the problem by imposing further rate increases. Where a carrier's

> returns have greatly exceeded a fair percentage of return upon a fair base, it follows as a matter of law that the rates charged . . ., instead of being "just and reasonable" as the law requires them to be, have been excessive. There is nothing new about this principle. Speaking for a unanimous Supreme Court, Chief Justice Taft said in 1924: "If the profit is fair, the sum of the rates is so. If the profit is excessive, the sum of the rates is so."[78]

And that is why the courts have made clear that permitting regulated entities to earn such excessive returns is the paradigm of arbitrary agency action and flatly violates an agency's

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[74] *Bell Atl. Tel. Cos.* v. *FCC,* 79 F.3d 1195, 1202 (D.C. Cir. 1996).

[75] 47 U.S.C. § 201(b) (emphasis added).

[76] *Id.*

[77] *See, e.g., American Tel. & Tel. Co.* v. *FCC.,* 572 F.2d 17 (2nd Cir. 1978).

[78] *Potomac Elec. Power Co.* v. *Public Utils. Comm'n of the District of Columbia,* 158 F.2d 521, 523 (D C Cir 1947) (quoting *Dayton-Goose Creek R Co v United States,* 263 U S 456, 483 (1924))

statutory obligation to establish just and reasonable rates.[79] Thus, where, as here, regulated carriers have been able to exercise market power and earn supracompetitive profits in increasing amounts year over year, the Commission must aggressively use its broad regulatory powers to ensure that such carriers charge just and reasonable rates." Indeed, the D.C. Circuit has previously held that it could not "countenance" excessive rates which "ensure 'creamy returns' to the carriers and are 'far more generous than those [rates] that the Commission and other regulators give elsewhere."' *Formers Union II*, 734 F.2d at 1503 (citations omitted).

That is especially true here, because the Commission's deregulation of special access rates was based on a predictive judgment that market forces would effectively constrain the Bells' prices.[81] That predictive judgment has not panned out – the Bells' own reported data show that competition has *not* protected special access customers from abuses of market power. It is therefore incumbent on the Commission to reassess its deficient special access regulations to account for these facts.[82]

The courts have made clear that where the Commission regulates rates on the basis of predictive judgments, it is imperative that "the Commission . . . vigilantly monitor the

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[79] *Jllinois Bell Tel. Co.* v. *FCC*, 988 F.2d 1254, 1260 (D.C. Cir. 1993); *Formers Union II*, 734 F.2d at 1497, 1502-03

[80] *See Farmers Union II*, 734 F.2d at 1497, 1502-03; ***see*** *also FPC* v. *Texaco Inc.*, 417 U.S. 380, 399 (1974) ("[i]n subjecting producers to regulation because of anticompetitive conditions in the industry, Congress could not have assumed that 'just and reasonable' rates could conclusively be determined by reference to market price").

[81] ***See*** *WorldCom* v. *FCC*, 238 F.3d 449, 459 (D.C. Cir. 2001) ("The FCC readily admits that its decision to adopt the thresholds contained in the *Pricing Flexibility Order* was dependent, at least in part, on the agency's predictive forecasts"); *see also id.* at 462 ("The FCC made a predictive judgment that the amount of collocation required for each trigger will be sufficient to constrain anticompetitive practices by incumbent LECs").

[82] Notably, the Commission itself recognized in the *Pricing Flexibility Order* that the Bells might abuse their flexibility to charge rates that were not just and reasonable, and that the Commission might have to take remedial action. *See, e.g., Pricing Flexibility Order* ¶ 83.

consequences of its rate regulation rules."[83] And "[i]f, in light of actual market developments, the Commission determines that competition is not having the anticipated effect on access charges," the agency must "revisit the issue." ***Texas Office of Public Utility Counsel*** v. ***FCC,*** 265 F.3d 313, 325 (5th Cir. 2001); ***see also*** *SWBT* v. ***FCC,*** 153 F.3d 523, 547 (8th Cir. 1998) (same); ***see also*** *CELLNET* v. *FCC,* 149 F.3d 429, 442 (6th Cir. 1998) ("If the FCC's predictions about the level of competition do not materialize, then it will of course need to reconsider its [regulations] . . in accordance with its continuing obligation to practice reasoned decisionmaking"); ***Bechtel*** v. *FCC,* 957 F.2d 873, 881 (D.C. Cir. 1992) (it is now "settled law that an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision . . has been removed."); *AFL-CIO* v. ***Brock,*** 835 F.2d 912, 916-17 (D.C. Cir. 1987) ("courts recognize that agencies must respond to changed circumstances to carry out Congress' purposes"). Put simply, because the Commission's predictive judgments concerning the ability of market forces to reign in the Bells' market power over access services have not materialized, it would be unlawful for the Commission to decline to modify its regulatory scheme in order to check the Bells' market power abuses.

The Commission has previously found it necessary to modify price cap regulation to ensure that access rates remained at "just and reasonable" levels. In 1995, the Commission found that "the price cap LECs had experienced higher earnings on average under price caps than in earlier periods" and found that these consistently high returns confirmed that the Commission's price cap system was not adequately keeping up with the LECs' cost improvements and adequately constraining the Bells' prices.[84] And again, in the CALLS ***Order,***

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[83] ***American*** *Civil* ***Liberties Union*** v *FCC,* 823 F 2d 1554, 1565 (D C Cir 1987) (emphasis added)

[84] ***See*** *Price Cap* ***Performance Review for*** *Local* ***Exchange Carriers,*** 10 FCC Rcd 8961, ¶ 100

recognizing that the then-current "traffic-sensitive rate structure provide[d] price cap LECs with more revenue when demand increases, regardless of whether costs have increased, resulting in higher earnings," the Commission "target[ed] reductions to [those] traffic-sensitive services."[85] Consistent with these prior actions, and with its affirmative duty to address unjust and unreasonable rates and failed predictive judgments, the Commission can and must take immediate action to address the Bells' current exercise of market power over special access services.[86]

The Commission cannot reasonably rely on the Section 208 complaint process to address the Bells' unlawful special access rates.[87] Neither the injured carriers nor the Commission has the resources to resolve such a nationwide problem in the context of hundreds of individual rate

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(1995), *aff'd, Bell Atlantic Tel. Cos.* v. *FCC*, 79 F.3d 1195, 1202 (D C. Cir. 1996) (upholding the order based in part on the fact that "[t]he Commission originally predicted that sharing would be rare, . . . [but i]n practice, sharing had become routine. By 1993, all seven of the Bell Operating Companies were in the sharing zone, leading the Commission to believe that the original X-Factor had been too low").

[85] *See CALLS Order* ¶ 171 & n.376

[86] The *CALLS Order* is no bar to re-establishing effective regulation of the Bells' interstate special access services. Indeed, the Commission expressly stated in the *CALLS Order* that "the Commission has authority to modify the rules we adopt today before the end of the five-year term of the CALLS Proposal," and that the "Order addresses a marketplace that is dynamic and evolving, and the Commission may exercise its authority should the need arise." *CALLS Order* ¶ 36 n.45.

Similarly, the CALLS Agreement does not bar the requested relief. Section 4.2 of that Agreement states simply that the mechanisms laid out in paragraphs 2 and 3 of the CALLS Agreement constitute a fair and reasonable means of moving "usage sensitive rates" to the point achieved by those mechanisms. That section applies only to usage sensitive *switched* access rates. ***See*** Memorandum of CALLS in Support of Plan, p 37 (August 20, 1999) (mechanisms in CALLS effect a freeze in the caps for the "services comprising switched access services"). In other words, Section 4.2 says simply that the means set forth in the Agreement for achieving the agreed-upon rates for switched access services (*i.e.*, what the *CALLS Order* terms the "average traffic-sensitive rate," or "ATS" rate) are a fair and reasonable means for achieving those rate levels. Section 4.2 does not apply to special access rates, which are not included in the **ATS** rates.

[87] *See* 47 U.S.C.§ 208.

cases. Indeed, taken to its illogical extreme, this argument would permit the Commission to abandon the field altogether so long as it held open the prospect of allowing individual complaint cases. It is precisely for these reasons that the courts of appeals have held that the existence of a "safety valve" that permits a variance from a generally applicable regulatory scheme does not excuse an agency from failing to address a systemic problem inherent in the underlying regulatory scheme. For example, in *Time Warner Entertainment Co., L.P.* v. *FCC*, 56 F.3d 151 (D.C. Cir. 1995), the court of appeals considered a challenge to a provision of the Commission's rate-cap regime for cable television. The Commission failed to permit recovery of cost increases incurred in the period between the date on which the baseline rates were set and the effective date of the regulations.[88] The Court rejected the Commission's attempt to justify its decision on the grounds that disadvantaged cable companies could always seek the imposition of cost-of-service ratemaking. Because that option "is costly . . . and is intended to be a limited 'safety-valve' exception," the court held that it cannot be a widely-used mechanism for correcting an imprudent rate scheme.[89] Accordingly, the Commission cannot rely on the complaint process to remedy the endemic and unlawfully excessive special access rates spawned by the Bells' anticompetitive behavior and the Commission's overly-permissive regulatory scheme.

The bottom line is this: The Commission adopted its aggressive deregulation of the Bells' special access services based on a predictive judgment that competition would provide sufficient safeguards to protect against the Bells' exercise of monopoly power over special access customers. Years of data now confirm that the Commission's predictive judgment was wrong. Competition has not developed for special access services, and the Bells have

[88] *See Time Warner*, 56 F.3d at 173

[89] *Id.; see also Ass'n of Oil Pipelines* v. *FERC*, 281 F.3d 239, 244 (D.C. Cir. 2002); *American Gas Ass'n* v. *FERC*, 912 F.2d 1496, 1517-18 (D.C. Cir. 1990); *ALLTEL Corp.* v. *FCC*, 838 F.2d

consistently exercised market power to extract massive windfalls from IXCs, CLECs and end-user customers. This evidence conclusively establishes that current Bell special access rates are not just and reasonable and, therefore, are unlawful.

Because the Commission has an affirmative duty to enforce the act by ensuring that special access rates are just and reasonable, the Commission can and must take immediate action to establish meaningful regulatory constraints on the Bells' rates for all of their special access services. At a minimum, the Commission should revoke pricing flexibility and reinitialize price caps to levels designed to produce normal, rather than monopoly, returns. Moreover, given that existing special access rates are so far out of line with lawful, compensatory levels, the Commission should also adopt immediate, interim relief while the rulemaking is pending. In particular, the Commission should: (1) immediately reduce all special access charges for services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return,[90] and (2) impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.[91] Retargeting special access rates to an 11.25% return on an interim basis is necessary to align prices more closely with what would be expected in a competitive market (and, indeed, with what was expected when the Commission granted pricing flexibility). Moreover, an 11.25% rate of return is the last authorized rate of return for the Bells

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551, 561 (D.C. Cir. 1988)

[90] The Commission could accomplish this easily by calculating the percentage reductions necessary to reduce each Bell's overall special access returns to 11.25%, and then applying that percentage reduction only to the rates that have been removed from price caps

[91] The Commission has ample authority to institute interim rate relief pending the completion of a rulemaking, ***see,*** *e.g., Lincoln Tel. & Tel. Co.* v. *FCC,* 659 F.2d 1092, 1107-08 (D.C. Cir. 1981), and also to impose a moratorium on any further pricing flexibility petitions while a rulemaking is pending, ***see*** *Neighborhood TV Co., Inc.* v. *FCC,* 742 F.2d 629, 634-40 (D.C. Cir. 1984); *Kessler* v. *FCC,* 326 F.2d 673, 679-85 (D.C. Cir. 1963); *Western Coal Traffic League* v. *Surface TransportationBoard,* 216 F.3d 1168, 1177 (D.C. Cir. 2000).

and is thus appropriate for retargeting rates on an interim basis (even though an 11.25% rate of return is quite generous given conditions in today's capital markets) In conjunction with this interim relief, the Commission should make clear that **(3)** this rate relief shall not trigger any termination liabilities or other penalty provisions of the Bells' OPP plans.[92]

[92] *See Local Exchange Carriers' Individual Case Basis DS3 Service Offerings*, CC Docket No. 88-136, 4 FCC Rcd. 8634, ¶ 79 (1989) (in ordering LECs to convert all individual case basis pricing for DS3 services to generally available rates, the Commission found that "we will not permit LECs to assess converted ICB customers termination liability charges or non-recurring charges").

CONCLUSION

For the foregoing reasons, the Commission (1) must reform and tighten rate regulation of the price cap ILECs' special access services, and (2) on an interim basis, should immediately reduce all special access charges for services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return and impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.

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